RESEARCH HIGHLIGHTS

October 2001 Socio-Economic Series Issue 93

RESIDUALIZATION OF RENTAL TENURE: ATTITUDES OF PRIVATE LANDLORDS TOWARD LOW-INCOME HOUSEHOLDS

Introduction

This research was undertaken with a grant under the CMHC External Research Program (ERP). ERP offers funding assistance to help Canadian researchers carry out research investigations on topics related to housing in priority areas identified by CMHC. However, the research is entirely the work of an external researcher and does not necessarily reflect the views of CMHC.

Objectives and Methodology

It was hypothesized that the characteristics of rental tenants are changing, with an increasing incidence of households characterized by low-income, low-employment levels and high dependency on government income assistance. The research drew upon European literature that has characterized this phenomenon as one of residualization—that is as higher income households advance into ownership, the residual group is becoming more marginalized from both the labour and housing market. That is, renters are becoming less able to find and retain employment and housing without some level of government support.

The research explored the particulars to ascertain if a shift in the characteristics of renters has been evident, and whether there are important implications for housing policy.

Distinct from the European literature, which has undertaken this analysis in the context of publicly assisted housing, this study examined the extent to which this trend has been evident in the private rental market in Canada.

In addition, the investigation sought to determine how landlords perceive this trend and how it might impact the propensity of investors to develop rental housing.

The research used three approaches to this exploration: a literature analysis; a statistical analysis of existing data on household characteristics; and a qualitative survey of two subgroups of rental investors—recent vendors and purchasers in two cities, Vancouver and Ottawa.

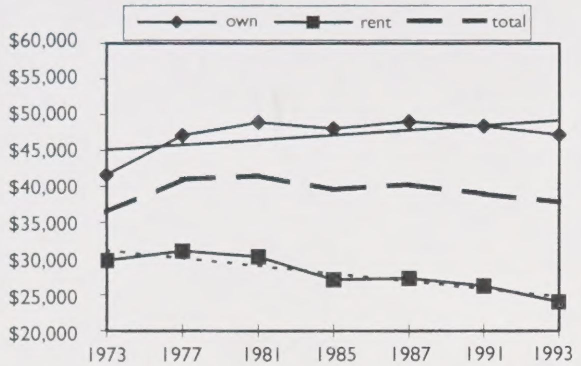
Key Findings

There is some evidence in the literature indicating that tenants with a particular profile may experience greater difficulty in accessing private rental housing. Other researchers have also noted the important distinction between discriminatory practices and prudent management, in which some selectivity is exercised in accepting new tenants. The study sought to explore these issues further in the landlord/investor interviews.

The statistical review found that there has been a long-term divergence in the income profile of renters and owners, although since 1990 both groups have, on average, experienced losses in real income. During the period between 1973 and 1993, renters as a group have seen their real income decline by 7 per cent while owners' incomes have increased by 18 per cent. In 1973 the median renter income was 71 per cent of owners; by 1993 their median income had fallen to only 58 per cent of the median owner.

As the term residualization is intended to portray, the divergence in income between the two tenures is not a result of different impacts on two unique and separate groups. It is likely a direct consequence of the movement

Figure 1: Median Real Incomes ($1991), by Tenure, with Trendlines



Source: HIFE Micro data file, by author

of renters into ownership tenure, particularly those households with better income prospects, who would otherwise have pulled up the average among tenants. As a result, the remaining (or residual) households tend to have a lower socio-economic profile.

The analysis also points out that weak income growth is not homogeneous across all renters. Certain household types and age groups seem to have experienced greater difficulty in earning an income. This is reflected in the employment outcomes experienced by each tenure, household type and age group. Both the young, new households (under 25), and those approaching retirement have clearly experienced the greatest difficulty in gaining and retaining employment and have accordingly experienced weak income growth levels.

The income decline among renters also reflects the growth of lone parent families, many of whom may already rent or resort to renting upon separation.

This trend is significant as those households who often have the greatest difficulty securing affordable rental accommodation—families with children—are also those most vulnerable to the destabilizing impact of income decline, or loss. Such employment loss can lead to eviction for non-payment of rent, the trauma of another search for housing and inevitably to a permanent position on the poverty merry-go-round and potentially a long-term dependency on social assistance.

Trends in welfare dependency were explored using the subset of government transfer payments available in the HIFE data set. Transfer payments were used as a proxy for social assistance benefits. On this basis, dependence on transfer payments is significantly higher among renters than owners. Dependency among renters tripled from 8.6 per cent in 1974 to 26 per cent in 1994; over the same period, transfers for owners have doubled, but from a lower base, from 3.7 per cent to 7.8 per cent.

Overall, the statistical review reveals a number of trends to confirm that some degree of residualization in the socio-economic profile of rental tenants is gradually occurring.

The study then explored the perceptions and attitudes of rental investors, specifically investigating whether they perceived the residualizing trend.

Interviews were conducted with a sample of rental investors in Vancouver and Ottawa—including both recent vendors and purchasers (sales during 1994-1995). Although property sales were selected on a stratified random sample, the method did not undertake a survey of sufficient size to facilitate a statically representative set of data. The purpose was to pursue an initial exploration of this issue and to generate a sense of the attitudes and outlook among rental investors. It also sought to identify the implications for rental housing policy and possible policy options.

It is important to bear in mind that the majority of the investors contacted were small-scale landlords, the majority owning only a single property that they managed themselves. It is also notable that these small-scale investors represent a large proportion of ownership in the rental sector. However, the findings do not necessarily reflect the attitude of large corporate and institutional investors—who tend to own larger properties.

The two markets in which the interviews were conducted are substantially different. Through the latter 1980's and early 1990's, Vancouver had experienced a period of strong, sustained economic growth and, by Canadian standards, has a very expensive housing market. Rental vacancy rates have been very low through the 1990's and remain at around 1%. With the cost of ownership among the highest in the country, the transition from rental into ownership is significantly more constrained in Vancouver than in the other parts of the country.

Conversely, the Ottawa market has been impacted by the generally weaker economy that prevailed through Ontario for the first half of the 1990's—which in Ottawa was exacerbated by various rounds of downsizing in the federal government. With some infusion of new rental development from the non-profit sector in the early 1990's, coupled with an oversupply of condominium units and relatively weak demand, vacancy rates have been soft, remaining above 4% since 1991 through 1996.

Accordingly, one would expect a different perspective from investors in both markets. This proved to be the case on most issues raised with investors. Differentiation in responses tended to be stronger between the two cities than it did between recent vendors (investors exiting the market) and new purchasers (entering the market).

The overall perspective on prospects for rental investment tended toward the negative.

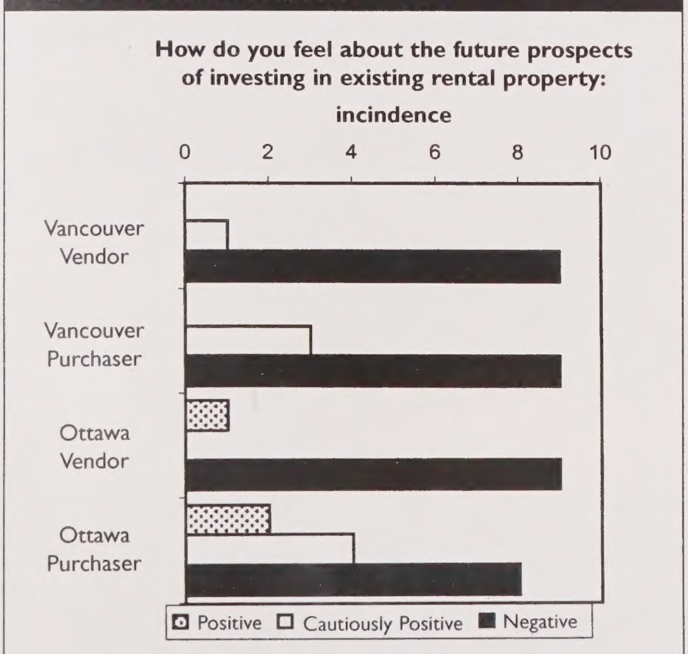
More than half of the investors expressed the opinion that the environment for rental investment is either much worse or slightly worse than it was 5-10 years ago. This came through more strongly in Ottawa, but somewhat surprisingly, there was evidence of a souring perspective among investors in Vancouver.

Looking to the future, the majority of investors expressed negative concerns about future prospects. Only three of the 54 investors interviewed expressed strong positive feelings about the future; fewer than one-fifth of investors were cautiously optimistic.

In terms of the central thesis, none of the investors explicitly identified with the concept of residualization. However, in an indirect way, they provided some evidence that they discern a changing profile among tenants; and that this is becoming a concern.

A majority of respondents agreed that the proportion of tenants that would be considered higher risk, or undesirable is increasing, and that it is becoming harder to find and retain good tenants. This was not, however,

Figure 2: Future Prospects



a causal factor among vendors that have recently divested from the market, although, again, it appeared to be an underlying element in their concerns about a weak potential, negative cash flow and poor returns. Almost one third of the recent purchasers felt that the problem of attracting good tenants was either a mild or serious concern in their particular property.

One in six landlords-investors confirmed that they would not accept households on welfare. Asked specifically to choose between various combinations of household types, the overwhelming choice was for a working couple. In selecting from these various combinations, none of the investors chose a welfare household and only one selected a lone parent with a young child, suggesting that such households will continue to experience difficulty as long as there is excess demand for lower priced units.

In exploring landlord attitudes about the need for affordable housing to serve lower-income tenants, landlords-investors did not contest the legitimacy of social housing and a direct government role in the provision of affordable housing. Many expressed interest in demand side approaches such as shelter allowances and rent supplements. However, they also saw a need for social housing, particularly to house households on low income and those on social assistance, whom some preferred not to accommodate.

The study concludes by recommending that further policy attention be given to the rental market particularly with regard to how existing policies and practices impact tenant characteristics.

It is noted in some respects that there is not a level playing field in terms of support for ownership and rental tenure. There has long been a preoccupation with increasing access to home ownership–recently, for example, RRSP downpayments and 95% mortgage insurance. To the extent that the rental market and home ownership sector are closely related, initiatives to enhance access to ownership contribute to weakening demand in the rental sector and are a factor in the trend to residualization. The residualizing trend has been identified as a factor impacting the attractiveness of investment in the rental sector.

The most immediate consequence of this increasing disinterest on the part of investors is the potential deterioration of first, the physical, and second the social environment of rental housing. This can then lead to a decline in the quality of life of both the tenants and the neighbourhood with serious long-term impacts on municipal expenditures on policing, social services and infrastructure.

The need for a mixed policy approach–with balanced policies directed to both the ownership and rental sector is identified. In relation to rental housing, this could include various types of demand side programs, such as shelter allowances and rent supplements, but should also be balanced with initiatives to assist the non-profit sector to acquire existing properties in which the private sector appears to be disinterested. The study found that a large number of properties are put up for sale each year and these are often available at a price that would approach an affordable level for lower-income households. Currently however, non-profit organizations do not have the capital to pursue such opportunities.

The study identifies an important distinction between discrimination and prudent management. It is argued that landlords are not necessarily adverse to specific household types, they simply associate risk of default and bad debt with certain characteristics. An appropriate policy response would be to focus on mitigating risk. Theoretically, this could be pursued through some form of industry-wide insurance program that protects investors against these risks, in the same way that mortgage loan insurance currently protects lenders against risk of mortgage default.

Such an insurance approach would not entirely mitigate such risk, nor would it necessarily eliminate selectivity. However, it would be useful in formalizing an objective system of risk analysis and could help to reduce the barriers that currently confront many lower-income households purely on the basis of stereotyping.

CMHC Project Contact: Kamal Gupta

ERP Grant Recipient: Steve Pomeroy
Focus Consulting (Ottawa)

Housing Research at CMHC

This project was funded (or: partially funded) by Canada Mortgage and Housing Corporation (CMHC) under the terms of the External Research Program (ERP), an annual research grant competition. The views expressed are the personal views of the author (s) and do not represent the official views of CMHC. For more information on the ERP, please visit the CMHC web site www.cmhc-schl.gc.ca or contact the Program Administrator by phone at (613) 748-2249, by e-mail at erp@cmhc-schl.gc.ca, or by regular mail: Program Administrator, External Research Program, Research Division, Canada Mortgage and Housing Corporation, 700 Montreal Road, Ottawa ON K1A 0P7.

To find more *Research Highlights* plus a wide variety of information products, visit our Web site at

www.cmhc-schl.gc.ca

or contact:

Canada Mortgage and Housing Corporation
700 Montreal Road
Ottawa, Ontario
K1A 0P7

Phone: 1 800 668-2642
Fax: 1 800 245-9274

OUR WEB SITE ADDRESS: www.cmhc-schl.gc.ca